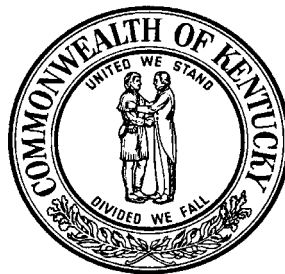


**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
DEPARTMENT OF EDUCATION**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

**For the Year Ended
June 30, 2005**



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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Ernie Fletcher, Governor
Gene Wilhoit, Commissioner
Department of Education

MANAGEMENT LETTER

KRS 43.090 (1) requires the Auditor of Public Accounts, upon completion of each audit and investigation, to prepare a report of all findings and recommendations, and to furnish copies of the report to the head of the agency to which the report pertains, and to the Governor, among others. This KRS also requires the Department of Education to, within 60 days of the completion of the final audit, notify the Legislative Research Commission and the Auditor of Public Accounts of the audit recommendations it has implemented and those it has not implemented and any reasons therefore. We are providing this letter to the Department of Education in compliance with KRS 43.090.

In planning and performing our audits of the Commonwealth for the year ended June 30, 2005, we considered the Department of Education's internal control over financial reporting and compliance with laws, regulations, contracts and grant agreements in order to determine our auditing procedures for the purpose of expressing opinions included in the audit of the CAFR and SSWAK and not to provide an opinion on internal control or on compliance.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The SSWAK is a separate report dated March 31, 2006, and contains all reportable conditions and material weaknesses in the Commonwealth's internal control structure and also contains all reportable instances of noncompliance. This letter does contain the Department of Education findings and our recommendations that have been extracted from the SSWAK report along with other matters that have been identified.

We will review the status of these comments during our next audit. We have already discussed many of these comments and suggestions with various Department of Education personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.



To the People of Kentucky
Honorable Ernie Fletcher, Governor
Gene Wilhoit, Commissioner
Department of Education

Included in this letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Findings and Recommendations
- ◆ Summary Schedule of Prior Year Audit Findings

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

LIST OF ABBREVIATIONS/ACRONYMS

CFDA	Catalog of Federal Domestic Assistance
EDU	Department of Education
FAP	Finance and Administration Policies
FY	Fiscal Year
KRS	Kentucky Revised Statutes
MARS	Management Administrative Reporting System
OMB	Office of Management and Budget
PBU	Program Budget Unit
ProCard	Procurement Card
U.S.	United States

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

CFDA #	Program Title	Expenditures		Provided to Subrecipient
		Cash	Noncash	
DEPARTMENT OF EDUCATION				

U.S. Department of Agriculture**Direct Programs:**

Child Nutrition Cluster:				
10.553	School Breakfast Program (Note 2)	\$38,991,179		\$38,902,462
10.555	National School Lunch Program (Note 2)	114,543,270		114,377,972
10.556	Special Milk Program for Children (Note 2)	44,692		44,692
10.559	Summer Food Service Program for Children (Note 2)	7,296,196		7,094,682

10.558	Child and Adult Care Food Program (Note 2)	26,555,935		26,160,440
10.560	State Administrative Expenses for Child Nutrition	1,556,691		

U.S. Department of Labor**Passed Through From the Cabinet for Workforce Development:**

17.259	WIA Youth Activities	669,469		579,534
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U.S. Department of Education**Direct Programs:**

84.010	Title I Grants to Local Educational Agencies (Note 2)	147,730,641		145,777,328
84.011	Migrant Education - State Grant Program	6,684,297		6,566,055
84.013	Title I Program for Neglected and Delinquent Children	6,418		

Special Education Cluster:				
84.027	Special Education - Grants to States (Note 2)	123,155,195		119,518,155
84.173	Special Education - Preschool Grants (Note 2)	10,705,673		10,705,673

84.184	Safe and Drug-Free Schools and Communities: National Programs	346,388		346,288
84.185	Byrd Honors Scholarships (Note 3) (Note 4)			
84.186	Safe and Drug-Free Schools and Communities - State Grants	5,010,456		4,808,023
84.196	Education for Homeless Children and Youth	712,896		698,950
84.213	Even Start - State Educational Agencies	3,272,780		2,531,605

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

CFDA #	Program Title	Expenditures		Provided to Subrecipient
		Cash	Noncash	
DEPARTMENT OF EDUCATION				
84.215	Fund for the Improvement of Education	77,619		30,000
84.287	Twenty-First Century Community Learning Centers	9,012,352		8,855,686
84.298	State Grants for Innovative Programs	4,476,382		4,175,105
84.318	Education Technology State Grants	8,391,563		8,350,632
84.323	Special Education State Program Improvement Grants for Children with Disabilities	472,442		472,442
84.326	Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	193,313		150,538
84.327	Special Education - Technology and Media Services for Individuals with Disabilities	169,051		169,051
84.330	Advanced Placement Program	412,447		865
84.332	Comprehensive School Reform Demonstration	3,752,952		3,593,841
84.350	Transition to Teaching	18,823		
84.357	Reading First State Grants	18,995,315		17,342,655
84.358	Rural Education	5,597,438		5,595,135
84.365	English Language Acquisition Grants	1,807,227		1,477,628
84.366	Mathematics and Science Partnerships	465,832		451,838
84.367	Improving Teacher Quality State Grants (Note 2)	44,229,985		44,136,808
84.369	Grants for State Assessments and Related Activities	8,388,807		172,345
84.NA(1)	School Renovation Grants (Old CFDA #84.352)	494,360		403,713
84.NA(2)	Eisenhower Professional Development State Grants (Old CFDA #84.281) (Note 3)			
Passed Through From Cabinet for Workforce Development:				
84.048	Vocational Education - Basic Grants to States	6,428,563		6,163,393
U.S. Department of Health and Human Services				
Direct Programs:				
93.576	Refugee and Entrant Assistance - Discretionary Grants	124,435		117,965
93.600	Head Start	76,940		

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

CFDA #	Program Title	Expenditures		Provided to Subrecipient
		Cash	Noncash	
DEPARTMENT OF EDUCATION				
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	498,719		371,276
Passed Through From the Cabinet for Health Services:				
93.110	Maternal and Child Health Federal Consolidated Programs	35,468		
U.S. Corporation on National and Community Service				
Direct Programs:				
94.004	Learn and Serve America - School and Community Based Programs	304,316		273,000
TOTAL DEPARTMENT OF EDUCATION		\$ 601,732,425		\$ 580,441,675

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Clusters of programs are indicated in the schedule by light gray shading.

Programs that do not have CFDA numbers are identified using the two-digit federal identifier prefix, and the letters “NA” to denote that no specific number is applicable. Each program is numbered in parentheses, following the NA for each federal grantor.

The state agencies’ schedule is presented on the cash, modified cash, or accrual basis of accounting.

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

Note 1 - Purpose of the Schedule and Significant Accounting Policies

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$20 million for FY 05. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 05, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

CFDA #	Program Title	Expenditures
Child Nutrition Cluster:		
10.553	School Breakfast Program	\$38,991,179
10.555	National School Lunch Program	114,543,270
10.556	Special Milk Program for Children	44,692
10.559	Summer Food Service Program for Children	7,296,196
10.558	Child and Adult Care Food Program	26,555,935
84.010	Title I Grants to Local Educational Agencies	147,730,641
Special Education Cluster:		
84.027	Special Education - Grants to States	123,155,195
84.173	Special Education – Preschool Grants	10,705,673
84.367	Improving Teacher Quality State Grants	44,229,985
Total Type A Programs		<u>\$513,252,766</u>

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

Note 3 - Zero Expenditure Programs

The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures.

Note 4 - Byrd Honors Scholarships Program (CFDA #84.185)

The Byrd Honors Scholarships Program was moved from the Kentucky Department of Education to the Kentucky Higher Education Assistance Authority.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 05-EDU-01: The Kentucky Department of Education Should Implement Procedures To Ensure All Budget Information Is Adequately Reported For ProCard Purchases**

We randomly selected 40 ProCard expenditures within the Department of Education and examined these purchases for compliance with FAP 111-58-00, *Procurement Card Program*. While reviewing these purchases, we noted several areas of noncompliance, which are detailed below:

- Twenty-three (23) instances (23 of 40, 57.5%) where the object code was not listed on the supporting documentation. Of those 23, 2 instances (2 of 40, 5%) where the project number on the supporting documentation differs from MARS and 1 instance (1 of 40, 2.5%) where the project was not listed on the supporting documentation.
- Three (3) instances where the object code listed on the supporting documentation differs from the object code recorded in MARS. (3 of 40, 7.5%)
- One (1) instance where the Fund, Program Budget Unit (PBU), and Reporting Category on the supporting documentation differ from that recorded in MARS. (1 of 40, 2.5%)

When the supporting documentation for ProCard purchases is not complete, it leaves open the possibility of incorrectly recording and charging to the wrong accounts. In addition, when the classification structure as shown on supporting documentation is different from what is reported in MARS, then it is difficult to determine the proper accounts are being charged for the purchases.

Section 13 of FAP 111-58-00 states, “An agency shall ensure that the proper classification structure is charged for the purchase.”

Recommendation

We recommend that the Department of Education implement procedures to ensure all budget information (i.e., Fund, Object Code, Program Budget Unit (PBU), etc.) is adequately reported on all supporting documentation for ProCard purchases and reported accurately in MARS. All ProCard supporting documentation and MARS transactions should be adequately reviewed to ensure the proper structure is charged for the expenditure. Any differences should be corrected and documented.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 05-EDU-01: The Kentucky Department of Education Should Implement Procedures To Ensure All Budget Information Is Adequately Reported For ProCard Purchases**

Management's Response and Corrective Action Plan

The Kentucky Department of Education agrees with your findings and we have implemented changes in our internal processes to ensure that accurate account funding information is documented on the procard invoices and other documentation.

One of our cardholders was not recording an object code on the documentation and has been asked to include that in all future documentation. In several instances, where the documentation funding did not agree with the charge in the MARS system, we found that the requested funding account or object code was inappropriate or could not be charged. Cardholders may not be aware that a purchase is eligible for 1099 reporting or that there is an inadequate allotment balance to fund the purchase. In those cases, we make the appropriate correction and use a different account or object code. In some cases, the documentation of the change was not recorded on the invoices. We have changed our procedures to ensure that we record those necessary changes.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Other Matters

(1) Audit findings that have been fully corrected:

FY 04	04-EDU-01	The Department Of Education Should Ensure That Receipts And Revenues Are Reported Correctly In The Management Administrative Reporting System.	N/A	0	Resolved in FY 05.
FY04	04-EDU-02	The Department of Education Should Ensure That Transfers of Expenditures Between CFDA's Are Reported Correctly On The Schedule of Expenditures of Federal Awards.	N/A	0	Resolved in FY 05.
FY04	04-EDU-03	The Department of Education Should Ensure That The Support Education Excellence In Kentucky Calculations Are Reviewed Prior To Payment.	N/A	0	Resolved in FY 05.
FY04	04-EDU-04	The Department of Education Should Implement Procedures For The Safe Custody and Retention of Audit Documentation.	N/A	0	Resolved in FY 05.

(2) Audit findings not corrected or partially corrected:

There were no findings to report in this category.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid:

There were no findings to report in this category.

